

THE TYPOLOGY OF REGIONAL MERGERS FROM THE PERSPECTIVE OF FINANCIAL-ACCOUNTING ASPECTS

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The interest for approaching this paper is determined by the actuality of the theme concerning mergers, and also by the scale proportions this type of transactions have arrived at, both at global level and also at national level, everything having as cornerstone a market economy within which competitiveness plays a more and more important role. The aim of the study consists in analyzing the external restructuring of entities under the form of mergers. On one side, in order to clarify and deepen the theoretical aspects concerning mergers, and on the other side, in order to identify certain features related to merger transactions in Cluj County. The aim of the study is to identify the conditions and manner of merger development within commercial entities from Cluj County and to establish a typology relying on the results concerning the relationship between the entities' shareholding structure, their contribution and the exchange ratio when performing the transactions. The actuality of the theme, the requirement and the increasing manifestation of the merger phenomenon also within the Romanian territory, the necessity of a thorough analysis of merger trends and typologies, they all have been trigger factors of this objective. In order to achieve the objective a research methodology was followed, assumptions were made, which have been confirmed or infirmed. The methodological sphere consists of an approach of considered quantitative and qualitative models, of techniques for data collection, hypotheses testing, but also of research boundaries. As a result of the processing and analysis of the data on which this study relies, one arrived to the following conclusions concerning mergers that were performed in Cluj County, conclusions which could lead to the elaboration of a typology for the mergers that have occurred in this region: in terms of shareholding structure, the two entities usually had a joint majority shareholder, and regarding the financial aspects, the contributions of both entities are in most of the cases positive, and the contribution of the absorbent entity is greater, and rarely, when the contributions are negative, these contributions usually belong to the absorbed entity. Also, when the shareholding structure is the same, the exchange ratio is usually 1:1.

Key words: merger, contribution, exchange ratio, positive equity, negative equity

JEL CODE: Accounting and Auditing: General M40; Mergers; Acquisitions; Restructuring; Voting; Proxy Contests; Corporate Governance G34

I. Introduction

The actuality and importance of merger as a restructuring form underlie the approach and analysis of this paper. The aim of the study is to identify the conditions and manner of merger development within commercial entities from Cluj County, and mainly to identify the typology of developed mergers from the perspective of previous bonds and of the contributions within the transaction. The main objective consists in obtaining certain results and also in establishing certain correlations concerning: the existent connections between the entities participant at the merger, respectively the connections between entities regarding shareholding structure and their contributions. In order to obtain the results the following three stages have been gone through: obtain the data, formulate the hypotheses and verify them. The first stage of the study concerning

the analysis of the entities participant at the merger consisted in collecting, processing and centralizing the data taken from the merger projects published within the Official Journal of Romania, part IV, and also the financial situations of the entities, published by the Ministry of Finance. The so obtained data have been centralized and encoded in worksheets, by means of SPSS statistical software, version 11. The second stage consisted in formulating the hypotheses relying on the legal provisions in force regarding the legal regime of mergers according to the Law no. 31/1990 concerning companies, with the subsequent modifications and additions of the Law no. 26/1990 concerning the Court of Registration, republished. On one hand, we took into account the identification elements of the entities involved in merger (entities' denomination, legal form, main object of activity according to NACE and founding year), and on the other hand, the financial elements (evaluation method, the value the transaction relied on, exchange ratio, merger premium). The third stage of the study consisted in finding solutions for the hypotheses formulated within the previous stage, using the instruments of descriptive statistics.

II. Research methodology

The methodological sphere consists of an approach of the considered quantitative and qualitative models, of techniques for data collection, hypotheses testing, but also of research boundaries. The quantitative and qualitative methods used are meant to analyze the experience for cognition, these methods being the most frequently approached within the field of economic sciences.

The quantitative data have been collected from the publications made within the Official Journal of Romania, part IV, being selected the entities which have performed merger operations in Cluj County, and also from the data collected from the financial situations published by the Ministry of Finance. The qualitative data were obtained by means of observation method and analysis, taking into account the fundamental criteria of research hypotheses. Both quantitative and qualitative data have been encoded and centralized in worksheets. The sample representing the object of this study consists of 103 commercial entities from Cluj County. The advantage of the study is that the collected data rely on public information, but it also involves certain boundaries derived from insufficiently detailed information. Even though the data collected from the publications furnished by the Official Journal have been substantially supplemented with those offered by the Ministry of Finance, some information remained incomplete. The cause of these boundaries can be attributed to the fact that merger projects are elaborated by the administrators of the participant entities or on their liability, and in most of the cases they do not have the necessary economic and legal knowledge to elaborate this sort of projects. Regarding the processing and the statistical analysis of data, we used the SPSS statistical software version 11 for encoding and centralizing the data, which were subjected to certain processing in order to establish correlations between variables, the influence degree of certain variables on others, all in order to obtain information as closer to practical reality as possible and to find solutions for the hypotheses.

III. Hypotheses' formulation and demonstration

Hypothesis 1

In most cases, the merger occurs between entities with the same shareholding structure or between entities with the same majority shareholder or when the absorbent entity possesses the absorbed entity in proportion of 100%.

Demonstration: The shareholding structure plays a decisive role when performing a merger, given the fact that a certain structure of the shareholding allows significant modifications within the development of the merger transaction. This position of the shareholding, of key element within the merger process, is prefigured in Law 31/1990, which states within the article 115, par. 2 that: "the decision to perform merger shall be taken by a majority consisting of at least two

thirds of the rights to vote possessed by the present shareholders or representatives". Another limitation may exist for the condition of majority shareholder, which is that imposed by the legislator in order to protect third parties, limitation which offers them the power to suspend the merger's development. The formulation of this hypothesis has its origins in the trend manifested on the Romanian territory of taking control by means of successive acquisitions of shares, followed by the merger operation after a certain period of time. It is important to mention here, the example of Astral Company, which had performed such an action for a long period of time.

Hypothesis 2

When participating at an absorption-type merger, the most common case is that in which the absorbent entity has the greater contribution.

Demonstration: We chose this hypothesis relying on the fact that the absorbent entity has, at the same time, a greater economic and financial power, which in most cases bestows this position. The economic and financial power is strongly related to the global value of an entity, which represents the entity's contribution within the merger. Therefore, a greater power would imply a greater contribution (and the other way around).

Hypothesis 3

In most cases, the contribution of the absorbent entity is positive, and the contribution of the absorbed entity is negative. If, within the merger operation, there are both positive and negative contributions, the negative ones belong to the absorbed entity, and the positive ones to the absorbent entity.

Demonstration: This hypothesis represents another consequence of the argument presented at the previous hypothesis, in other words, it is a sequel and depth of that certain hypothesis. In addition we can mention that, in most cases, the companies decide to merge and to be absorbed when they are in an unfavorable situation from an economic, financial or profitability perspective.

Hypothesis 4

If the merger contribution of the absorbed entity is negative, the merger occurs only if between the absorbed and absorbent entities there is a relation concerning the shareholding.

Demonstration: When the decision to perform a merger is made, the agreement must be consented by all the entities which participate to the merger. Every merger involves dealing with certain risks, both by the participant entities and their shareholders/associates. Absorbing an entity with negative contribution (which may indicate major financial difficulties) obviously involves a higher risk, which can be accepted easier when between the entities there is a relation concerning the shareholding. We consider that the takeover of a negative net merger contribution by the absorbent entity does not affect the participation rate to the capital of the shareholders/associates of the entity resulted after merger, given the fact that they are also shareholders of the absorbed entity.

Hypothesis 5

In most cases, the 1:1 exchange ratio is determined only when the merger occurs between entities with the same shareholding structure.

Demonstration: The financial evaluation is the support when establishing the exchange ratio, the central elements of negotiation. Talking about negotiation, it is not compulsory for this exchange ratio to be established taking into consideration the mathematically determined values; it can also be a 1:1 exchange ratio, namely, a share from the company that makes the contribution gives the right to a share within the company that benefits from the contribution or this contribution can be

established by agreement between the participants. Therefore, basically, the exchange ratio can be both objective and conventional. When the entities that participate to the merger have the same structure of the shareholding (are possessed by the same legal persons/individulas) the calculation of a exchange ratio is not justified. When the absorbent entity possesses 100% of the absorbed entity, the merger operation is strictly a substitution of financial assets with the merger contribution made by the absorbed entity, and from the structure perspective, the capital of the absorbent entity does not suffer modifications, in this case the exchange ratio is not justified. The social capital of the absorbent entity does not increase with the social capital of the absorbed entity, but the shares possessed by the absorbent entity are annulled. Therefore, we consider that in order for a 1:1 exchange ratio to exist, the entities should have the same structure of the shareholding.

IV. Results, processing and interpretations

Hypothesis 1 (Table 1: Structure of the shareholding)

Shareholding structure				
Type of structure	Name	Absol values	No. of answers	No. of cases
Independent	STRCTIND	9	11,3	12,7
Same structure	STRCTACE	20	25,0	28,2
Joint majority shareholder	STRCTACT	31	38,8	43,7
The absorbent owns 100% of the absorbed	STRCTABN	6	7,5	8,5
The absorbent owns shares within The absorbed	STRCTNPR	14	17,5	19,7
Total answers		80	100,0	112,7
3 missing cases; 71 valid cases				

(Made by authors)

After processing the data one can observe that, in Cluj County, the relation between the entities concerning the shareholding structure is as it follows: in most cases, the companies have a joint majority shareholder (43.7% from the considered types of structure), have the same structure (28.2%) or the absorbent owns shares within the absorbed company (19.7%). Regarding this hypothesis, we must mention that an entity can have one or multiple types of shareholding structures from the above mentioned list. *Hypothesis 1 : partially confirmed*

Hypothesis 2 (Table 2: The contribution of the absorbent)

The contribution of the absorbent (greater/smaller)

	Frequency	Percentage	Valid percentage
smaller	18	24.3	26.5
greater	50	67.6	73.5
Total	68	91.9	100.0
Missing	6	8.1	
Total	74	100.0	

(Made by authors)

By analyzing the frequency table, we can observe that for most of the entities that merged, the absorbent has the greater contribution, in 74% of the entities from Cluj County that offered this information. For the remaining 26% of the entities, the absorbent has a smaller contribution than the contribution of the absorbed entity. *Hypothesis 2: confirmed*

Hypothesis 3 (Table 3: Type of contribution)

The status of the entity within merger*Type of contribution

			Type of contribution		Total
			positive	negative	
Status of the entity within merger	Absorbent	Absolute value	21	3	24
		% from the entity's status	87.5%	12.5%	100.0%
		% from total	30.0%	4.3%	34.3%
	Absorbed	Absolute value	35	11	46
		% from the entity's status	76.1%	23.9%	100.0%
		% from total	50.0%	15.7%	65.7%
Total		Absolute value	56	14	70
		% from the entity's status	80.0%	20.0%	100.0%
		% from total	80.0%	20.0%	100.0%

(Made by authors)

From the 70 entities that furnished the necessary information for demonstrating this hypothesis, 80% had a positive contribution and 20% a negative one. From the 20% of the entities with negative contribution, 15.7% were absorbed and 4.3% absorbent. And from the 80% of the entities with positive contribution, 50% were absorbed and 30% absorbent. The proportion of negative contribution is greater at the absorbed entity (23.9%) compared to the absorbent (12.5%). *In conclusion*, in most cases, the entities (irrespective of their status of absorbent or absorbed), had a positive contribution. However, the proportion of negative contribution at absorbed entities is greater than in the case of absorbent entities, therefore, it is more likely the negative contribution to belong to the absorbed entity. **Hypothesis 3: partially confirmed**

Hypothesis 4

For the entities from Cluj County that had performed merger, this hypothesis was not confirmed. The statistical processing furnished the following results:

The negative contribution occurred both when there was a relation between the entities concerning the shareholding, and when the entities were independent. The negative contribution occurred in the following cases of shareholding structures: independent, joint majority shareholder, the absorbent owns shares within the absorbed. The other cases were not registered within the considered entities. As we mentioned within other demonstrations of hypotheses, in most of the cases the contributions were positive, irrespective of the shareholding structure.

Hypothesis 4 : unconfirmed (Table 4: The negative contribution of the absorbed entity when there is a relation concerning the shareholding)

Independent*Type of contribution					
			Type of contribution		Total
			positive	negative	
Independent	No	Absolute value	48	10	58
		% from Total	71.6%	14.9%	86.6%
	Yes	Absolute value	5	4	9
		% from Total	7.5%	6.0%	13.4%
Total		Absolute value	53	14	67
		% from Total	79.1%	20.9%	100.0%

The same structure*Type of contribution					
			Type of contribution		Total
			positive	negative	
The same structure	No	Absolute value	33	14	47
		% from Total	49.3%	20.9%	70.1%
	Yes	Absolute value	20		20
		% from Total	29.9%		29.9%

Total		Absolute value % from Total	53 79.1%	14 20.9%	67 100.0%
Joint majority shareholder					
			Type of contribution		Total
			positive	negative	
Joint majority shareholder	No	Absolute value % from Total	34 50.7%	5 7.5%	39 58.2%
	Yes	Absolute value % from Total	19 28.4%	9 13.4%	28 41.8%
Total		Absolute value % from Total	53 79.1%	14 20.9%	67 100.0%
The absorbent owns 100% of the absorbed					
			Type of contribution		Total
			positive	negative	
The absorbent owns 100% of the absorbed	No	Absolute value % from Total	48 71.6%	14 20.9%	62 92.5%
	Yes	Absolute value % from Total	5 7.5%		5 7.5%
Total		Absolute value % from Total	53 79.1%	14 20.9%	67 100.0%
The absorbent owns shares within the absorbed					
			Type of contribution		Total
			positive	negative	
The absorbent owns shares within the absorbed	No	Absolute value % from Total	44 65.7%	10 14.9%	54 80.6%
	Yes	Absolute value % from Total	9 13.4%	4 6.0%	13 19.4%
Total		Absolute value % from Total	53 79.1%	14 20.9%	67 100.0%
(Made by authors)					

Hypothesis 5 (Table 5: The 1:1 exchange ratio and the shareholding structure)

Independent*Exchange ratio

			Exchange ratio		Total
			mathematic	Without ratio or unspecified	
Independent	yes	Absolute value % from the Independent % from Total	4 44.4% 5.6%	5 55.6% 7.0%	9 100.0% 12.7%

The same structure*Exchange ratio

			Exchange ratio			Total
			negotiated	1:1	mathematic	
The same structure	yes	Absolute value % from the Same structure % from Total	3 15.0% 4.2%	15 75.0% 21.1%	2 10.0% 2.8%	20 100.0% 28.2%

Joint majority shareholder*Exchange ratio						
			Exchange ratio			Total
			negotiated	1:1	mathematic	
Joint majority shareholder	yes	Absolute value	7	10	14	31
		% from the Joint majority shareholder	22.6%	32.3%	45.2%	100.0%
		% from Total	9.9%	14.1%	19.7%	43.7%
The absorbent owns 100% of the absorbed*Exchange ratio						
			Exchange ratio			Total
			negotiated	mathematic	without ratio or unspecified	
The absorbent owns 100% of the absorbed	yes	Absolute value	2	2	2	6
		% from The absorbent owns 100% of the absorbed	33.3%	33.3%	33.3%	100.0%
		% from Total	2.8%	2.8%	2.8%	8.5%
The absorbent owns shares within the absorbed*Exchange ratio						
			Exchange ratio			Total
			negotiated	1:1	mathematic	
The absorbent owns shares within the absorbed	yes	Absolute value	2	2	10	14
		% from the Absorbent owns shares within the absorbed	14.3%	14.3%	71.4%	100.0%
		% from Total	2.8%	2.8%	14.1%	19.7%
(Made by authors)						

For the entities from Cluj County, the processing indicates that the 1:1 exchange ratio occurs with the highest proportion (75% from all the types of ratios, for that certain structure of shareholding) when within the entities there is the same shareholding structure. Moreover, this 1:1 exchange ratio also occurs within the other shareholding structures, as it follows: for “joint majority shareholder” in proportion of 32.3% from all types of ratios, and for “the absorbent owns shares within the absorbed” in proportion of 14.3%. The exchange ratio does not exist when the companies that participate to the merger are independent, from the shareholding structure’s perspective. *In conclusion*, the 1:1 exchange ratio mostly occurs when there is the same shareholding structure; it also occurs in other shareholding structures, but it does not exist in the case of independent entities. ***Hypothesis 5: partially confirmed***

V. Conclusions

The merger by means of absorption remains the most complex operation, especially when between the participant entities there are connections before the merger occurs. Within this type of merger, when establishing the value of the contribution brought by the participant entities, three special situations are identified:

a) **the absorbent company has positive equity, and the absorbed company has negative equity**; in this situation there is no exchange ratio, and the absorbent entity will not issue shares in order to remunerate the contribution of the absorbed entity. We consider that a situation of this kind can occur when between the absorbent and the absorbed there are previous connections, namely the absorbed is owned by the absorbent or the entities that merge have a joint majority shareholder or they have the same shareholding structure. The absorbent entity will approve to takeover a negative contribution if it considers that the contribution of the absorbed entity will

lead to increase the performances subsequent to the merger operation. Regarding the accounting reflection, the patrimonial asset and liability elements are transferred between the two entities, and the difference between the asset and liability elements of the absorbed entity at the moment of the takeover within the absorbent's accounting shall be reflected within the result, but within the result of previous financial years.

b) the absorbent company has negative equity, and the absorbed company has positive equity; if the absorbent entity has a negative net contribution, in order to determine the exchange ratio, one will consider the nominal value of a share in order to establish the number of shares the absorbent entity has to issue for remunerating the absorbed entity's contribution, according to the example of accounting reflection of operations concerning the Order 1376/2004. We consider that, in this case, the shareholders/associates of the absorbed entity are affected by this kind of exchange ratio. Therefore, we believe that, in order to simplify the situation, the entities should consider a reverse operation, basically the absorbent entity should be the entity with the highest merger contribution, and in order to determine a fair exchange ratio, it could be a conventional ratio, negotiated between participants.

c) both the absorbent and the absorbed companies have negative equity. When both participant entities have negative contributions, we consider that an exchange ratio cannot be determined. Therefore, the operation relies on negotiation between parties; basically the patrimonies of the two entities merge in terms of a conventional exchange ratio or without share issuance by the absorbent entity.

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